Testimony of

Kate Sullivan

Executive Director, Health Care Policy

U.S. Chamber of Commerce

before the

United States Senate

Special Committee on Aging

"Health Savings Accounts"

May 19, 2004

The U.S. Chamber of Commerce is pleased to testify at today's hearing about the benefits of Health Savings Accounts. I am Kate Sullivan, the Chamber's executive director of health care policy, and I have been involved in health care policy for 18 years as a staff advisor in the U.S. House of Representatives, to a former state governor and in various capacities in the private sector. The U.S. Chamber of Commerce is the world's largest business federation representing employers of every size, sector and region, and has engaged for a number of years in advocating that all Americans have health coverage through an appropriate mix of market reforms, public financing and a meaningful safety net. Moreover, everyone in this country, whether privately covered, publicly subsidized or uninsured, has a right to expect that our health system has at its root the best possible quality with uncompromising standards of safety.

Enactment last year of Health Savings Accounts ("HSAs") came at a critical time for America's employers, working families and those who buy their own health coverage, all of whom face challenges due to the increasing costs of health plans.

HSAs offer a great many advantages for employers of all sizes and to workers at any point in their lives—particularly at those times when they are not working. I will discuss here the importance of ensuring healthy market competition, into which HSAs are a welcome entrant, to help lower health care costs and improve our health care system, and to discuss the outlook of HSAs in the employee benefits arena and for older workers. Regardless of how one arranges his health coverage, however, we understand that an ideal health system involves many elements that must work together, a few components of which are private sector choices, effective use of the tax code, and greater use of disclosure information.

Reducing Health Insurance Costs through Market Competition

The insurance market, particularly for small businesses, has largely stagnated over the last five years. Time and time again since the late 1990s, small businesses have been forced to get a new health plan because their insurer has left the marketplace. Other employers have found that they have no other insurers in their area to call for a rate quote when their current plan premiums skyrocket. This lack of competition stems from state mandates on health plans, which have taken away health plans' ability to differentiate themselves in the marketplace and compete for customers by offering benefits tailored to meet their needs. When carriers leave the market, they leave employers with one less place to go with their business, and concentrate the market power of one or two dominant insurance companies. Health Savings Accounts hold the promise of reviving the largely moribund but costly small business insurance market.

HSAs were established in the Medicare prescription drug law and went into effect on January 1, 2004, and will replace their more restrictive Archer MSA predecessor. While a number of larger employers have experimented with so-called

"consumer-driven health plans" made possible by health reimbursement arrangements ("HRAs"), non-discrimination compensation testing largely prohibit these plan designs for some small businesses and partnership arrangements.

The HSA Advantage

Along with injecting new competition for employers' premium dollars, HSAs also offer a number of advantages for employees. Of primary benefit, the account is held exclusively by the taxpayer, rather than the employer. Employers may contribute to the HSA (as may the employee), easing concerns for younger or less affluent workers about funding their deductibles. As with other compensation requirements, employer contributions must be made fairly across the employee base, and HIPAA requirements for preexisting conditions will require that contributions not vary based on an employee's health status.

The Small Group Market. HSAs have already jump started the small group health insurance market in 2004. Many small businesses had already been forced to adopt higher deductible health plans as insurance costs nearly doubled over the last five years. Insurers specializing in these kinds of health plans are reentering states where they had once done business and left, or are becoming new market alternatives to the one dominant insurance carrier serving the small group market in a given area. Traditional insurers are also offering HSA products in an effort to retain small business customers. Small businesses desperately need this market competition for their substantial premium dollar.

The Large Employer Market. Because the benefits planning and enrollment cycle for larger employers had long been completed by the time HSAs were enacted last December, 2005 is the first year many of these employers can contemplate adding this option to their array of benefit offerings. The earliest stages of the 2005 planning

cycle is now just getting underway for most companies and will continue through this summer. Typically, employees make their selections in the autumn months. The Treasury Department is to be commended for recognizing the realities of the employee benefits calendar and working to issue guidances to employers and their consultants in time for the 2005 cycle.

The Individual Market. HSAs are also an option for those without employer-sponsored coverage. For certain individuals, HSAs also offer a pre-tax mechanism for paying for the required accompanying high-deductible health plan insurance when the account holder does not have workplace coverage, the first time the tax code has made this allowance. Premiums may be paid from HSA balances, though annual contributions are still restricted to the amount of the annual deductible. Therefore, greater tax code equity changes must still be made. President Bush and Congressman Phil Crane have put forth important proposals allowing all individuals who purchase their own high-deductible health plans to deduct their insurance premiums.

HSAs as an Employee Benefit Option

Employers are getting ready to incorporate HSAs into their employee benefit offerings. A recent Mercer Consulting survey of nearly 1,000 employers this past March found that while two out of five employers were likely to offer an HSA option next year (less than 10% reported that they were "very likely" to do so), nearly three-quarters said they were likely to do so in 2006 (with one out of five saying they were "very likely" to offer an HSA then).

Already, 19% of respondents said they offer a high-deductible health plan to their employees, predominantly very small businesses (32% of those with 10-49 employees) and very large entities (28% of those with more than 20,000 employees). Because of transition rules put forth by the Treasury Department for 2005 and 2006,

informed and motivated employees could establish their own HSA savings vehicle in the absence of formal sponsorship by their employers.

Employer Contributions to HSAs. While some employers had already adopted higher deductibles in recent years due to rising costs and premiums, many employers in the Mercer survey reported that they intended to contribute at least in part to an employee's health savings accounts, deflating some critics' arguments that HSAs will simply shift more costs to employees.

- First, most employers (61%) intended to adopt only the minimum $1,000 deductible (for single coverage), while only 10% would establish a deductible above $2,000.
- Then, about a fourth (24%) said they would contribute $500 to the savings account, 17% would contribute $1,000, 5% would contribute $1,500, and 6% would contribute the maximum $2,600.
- For 77% of employers, their contribution amount was lower than the deductible amount they selected, while another 13% would contribute fully to the deductible.
- Among those reporting that they would make a contribution, the average amount was $1,089.
- Interestingly, the smallest businesses (those with 10 to 49 employees) reported the highest expected contributions ($1,560).
- Thirty-nine percent of employers contemplating HSAs did not plan to contribute to the savings account of employees.

Transition Guidance from Treasury Has Been Essential

Employers of all sizes have been waiting for the Treasury Department's guidances before establishing these plan options, three of which have already been issued.

Flexible Spending Accounts and Health Reimbursement Arrangements. The most recent departmental guidance discussed the interaction of HSAs with Flexible Savings Accounts, which are commonly used to pay out-of-pocket deductibles and copayments as well as non-covered services, supplies and over-the-counter medications. In short, employees will continue to avail themselves of FSAs so long as these accounts --as well as consumer-centered Health Reimbursement Arrangements--are restricted to benefits for vision, dental or preventive care, or are used to cover expenses in excess of the annual deductible. However, employees must still budget carefully: Unspent funds at the end of the year are forfeited to the employer. Consequently, only 34 percent of eligible employees participate in their workplace FSA, and many under-budget their need.

We hope the Senate will follow the House's action last week and modify the so-called FSA "forfeiture" rule. By allowing a rollover of unspent funds to the next year's FSA or to an HSA if one is available, employees will be less likely to embark on a spending spree of unneeded medical, dental or vision services and supplies. To reduce the cost of such a change in policy, the U.S. Chamber of Commerce strongly urges lawmakers to allow employees the option of withdrawing any amount of their funds on an after-tax basis. The U.S. Treasury currently forfeits income and payroll taxes on unspent funds that revert to the employer, and the House-passed bill does not contain this option.

Making HSAs Work in 2004 and 2005: Banks and Rx Benefits. As many employers had already adopted high-deductible health plans if not HSAs as the Congress later envisioned them, individual employees enrolled in these plan options could establish a qualified account on their own. However, two significant barriers have prevented this from happening. First, many financial institutions where employees may already bank, maintain an IRA or hold their investments, are not yet offering qualified accounts. Treasury has therefore given individuals until next April 15 (of 2005) to establish and account for 2004 and 2005. We are pleased that many health plans are also working to establish proprietary banking options to facilitate FSAs for their employer clients.

The second barrier has been the treatment of prescription drugs relative to the medical plan's deductible. Most health plans, and nearly all employer-based plans, manage prescription drug benefits separately from other medical benefits in an effort to contain rapid expenditure growth over the last five years. These plans utilize formularies and a schedule of fixed-dollar copayments or percentage coinsurance to encourage the use of the most cost-effective and clinically appropriate medication. Many of these medically necessary drugs help users to avoid more costly medical services. Unfortunately, HSA law does not allow health plans to "carve out" prescription drugs from the health plan.

The Treasury Department's March guidance provides transitional relief through 2005. However, beginning in 2006 -- absent a change in the HSA law -- employers must re-vamp their benefits significantly in order to bring prescription drugs under their overall medical deductible thresholds. Despite the Mercer survey, which was conducted prior to Treasury's most recent guidance and further study of the matter by employee benefit professionals, few employers report that they are likely to adopt HSAs until this matter is resolved permanently, which would require legislation.

Moreover, subjecting prescription drugs to the deductible would trigger more expensive medical benefits coverage above the deductible much sooner, resulting in either higher health plan expenses and premiums, or forcing employers to adopt even higher deductibles for their HSA options, which could dampen employees' enthusiasm for them. We urge the Congress to take action well before May 2005, when employers are planning for 2006, to exempt prescription drugs from the high-deductible requirement of HSAs.

HSA Advantages for Older Workers

It is no secret that employers have scaled back retiree health coverage in recent years as health plan expenses have soared and threatened the affordability of coverage for active employees. The HSA law offers the ability of older workers (those aged 55 to 64) to contribute additional funds above the deductible in preparation for their necessary medical expenses once they attain Medicare eligibility. A recent study by the Employee Benefits Research Institute finds that working age Americans are ill-prepared to manage the staggering cost of their personal financial obligations for medical care once they retire. Just as today's workers need to plan at a young age for retirement income and not rely solely on Social Security, they must also plan for medical costs that Medicare will not cover. Nearly half of employers with more than 500 employees in the Mercer HSA survey report that they view HSAs as a savings vehicle for post-retirement medical coverage, while more than one-third (36%) of smaller employers -- who are far less likely to offer retiree health coverage -- report this motivation for offering an HSA.

Reducing Health Care Costs through Better Information

To work most effectively, all health system consumers, but especially those with Health Savings Accounts and other plan designs which encourage active

consumer behavior, must have far better information about the medical delivery system than that which exists today. Information is an important component to reducing costs and ensuring good outcomes—whether that information is about provider performance, best treatment options, available health plan choices or ways to improve one's own personal health. Components of better information to improve quality and lower costs include:

- Sharing information about provider performance;
- Developing evidence-based protocols to reduce practice variation;
- Eliminating medical errors through greater use of technology-based information systems;
- Steering patients to providers dedicated to quality improvement and best practices; and
- Disclosing the cost of items and services so patients can, when appropriate, compare prices relative to benefit.

Further research into clinical treatment protocols will enhance patient care, reduce practice variation and health care disparities, and improve patient outcome. This research should be supported in the public and private sectors, its results widely disseminated, and the ensuing protocols incorporated into reimbursement systems. Providers should be rewarded for being efficient and treating patients successfully the first time; the current system pays to correct each medical complication, side effect and even error. Employers do not wish to spend their health care dollars in such haphazard fashion, and some are revising their payment systems to promote efficient care. Medicare is also experimenting with such an approach, and we encourage these developments.

Similarly, employers have demanded greater use of technology based systems for patient care, resulting in more electronic records and prescription ordering, minimizing the chance of handwriting errors and speeding information retrieval in easily sorted formats.

HSAs and Tax Incentives Augment, not Undermine, Employer Coverage

Critics of market-based health care solutions are working overtime to convince policymakers that the widespread use of Health Savings Accounts and health insurance tax incentives aimed at individuals will undermine the employer-based health system. In fact, such windmill-tilting exercises divert attention from the true enemy of the system of which 136 million American employees of private employers and their dependents rely: COST.

No longer can employers allow dollars that should go into paychecks—and eventually to be recirculated into the economy—instead go to insurance premiums and the health system as a whole when so little accountability is demanded. HSAs and their companion health plans can improve this situation, and return more of one's paycheck to other sectors of the economy.